

## Message Text

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PAGE 01 OTTAWA 01915 241815Z  
ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01  
INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06  
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R 241758Z MAR 77  
FM AMEMBASSY OTTAWA  
TO SECSTATE WASHDC 2897  
INFO AMCONSUL MONTREAL  
ALL OTHER CONSULATES IN CANADA (BY POUCH)

UNCLAS OTTAWA 01915

E.O. 11652: N/A  
TAGS: EFIN, ECON, CA  
SUBJECT: BOUEY WARNS AGAINST HALT TO INFLATION FIGHT

1. SUMMARY. IN BANK OF CANADA ANNUAL REVIEW RELEASED MARCH 21, GOVERNOR BOUEY MAINTAINS THAT INFLATION IS STILL NUMBER ONE ECONOMIC PROBLEM IN CANADA AND THAT "ROOT OF OUR CURRENT EMPLOYMENT AND TRADE DIFFICULTIES LIES IN THE PERSISTENCE OF INFLATIONARY PRACTICES." HE INDICATES HIS PREFERENCE FOR CONTINUING CONTROLS AND FOR GRADUALISM IN REDUCING INFLATION TO POINT WHERE CANADIAN GOODS ARE AGAIN COST COMPETITIVE WITH U.S. PRODUCTS. HE REITERATES BANK POLICY ON RELATIVELY RESTRICTIVE MONETARY GROWTH AND SAYS MONETARY EXPANSION "WILL MOVE OVER TIME TOWARDS A RATE COMPATIBLE WITH INFLATION-FREE GROWTH OF THE ECONOMY." END SUMMARY

2. BANK OF CANADA GOVERNOR G.K. BOUEY, IN ANNUAL REPORT OF BANK ISSUED ON MARCH 21, STRESSES NEED FOR CONTINUED FIGHT AGAINST INFLATION. ALTHOUGH HE CHARACTERIZED 1976 AS "GOOD YEAR" IN BRINGING DOWN PRICE AND COST INFLATION THROUGH "STRATEGY OF GRADUALISM" OF CONTROLS  
UNCLASSIFIED

UNCLASSIFIED

PAGE 02 OTTAWA 01915 241815Z

AND MODERATE MONETARY EXPANSION, BOUEY CLAIMS INFLATION FIGHT "MUST GO ON, NOT FOR MONTHS BUT FOR YEARS."

3. SINCE "AVERAGE MONEY INCOMES" HAVE RISEN FASTER IN CANADA THAN IN U.S., WITHOUT GREATER INCREASE IN PRODUCTIVITY, BOUEY SAYS THAT COSTS HERE HAVE ESCALATED TO POINT WHERE CANADA CANNOT COMPETE EFFECTIVELY

WITH U.S. AND OTHER FOREIGN SUPPLIERS "IN MANY AREAS WHERE WE DO NOT HAVE SOME IMPORTANT NATURAL OR HISTORICAL ADVANTAGE." "UNUSUALLY LARGE SIZE OF OUR CURRENT ACCOUNT DEFICIT (IN 1976) STRONGLY SUGGESTS THAT WE ARE LOSING JOBS IN CANADA, AND THIS WAS BASICALLY BECAUSE WE HAD PRICED OURSELVES OUT OF MARKETS AT HOME AND ABROAD AND WERE CONTINUING TO DO SO."

4. BOUEY WARNS AGAINST CORRECTING UNEMPLOYMENT PROBLEM THROUGH EXCESSIVELY RESTIMULATING ECONOMY, "SINCE THE ROOT OF OUR CURRENT EMPLOYMENT AND TRADE DIFFICULTIES LIES IN THE PERSISTENCE OF INFLATIONARY PRACTICES, IT WOULD BE EXTRAORDINARY TO SUPPOSE THAT THEY COULD BE CURED BY FINANCIAL POLICIES SO EXPANSIONARY AS TO ENCOURAGE INFLATIONARY BEHAVIOR OR FOR THAT MATTER BY PROTECTIONIST POLICIES. SUCH POLICIES WOULD SIMPLY MAKE THINGS WORSE."

5. BOUEY ACKNOWLEDGES DEBATE ABOUT ENDING CONTROLS, "WITH MANY VOICES CALLING FOR THEIR EARLY TERMINATION." "WE SHOULD BE PREPARING TO LIVE WITHOUT THEM," BOUEY STATES, BUT "A MAJOR CRITERION FOR WITHDRAWING THEM EARLIER THAN WAS ORIGINALLY ENVISAGED SHOULD BE WHETHER COSTS AND PRICES ARE LIKELY TO BE LOWER WITHOUT CONTROLS THAN WITH THEM." CASE FOR ENDING CONTROLS EARLY IS WEAKENED IF GROUPS IN ECONOMY ARE LOOKING TO CONTROLS' END AS MOMENT FOR "UPWARD PUSH IN THEIR MONEY INCOMES AND PRICES."

UNCLASSIFIED

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PAGE 03 OTTAWA 01915 241815Z

6. "THERE CAN BE NO LASTING PROSPECTS OF GOOD PRICE AND COST PERFORMANCE IF THE RATE OF MONETARY EXPANSION IS EXCESSIVE," BOUEY STATES. "ALL CANADIANS SHOULD BASE THEIR DECISIONS ON THE EXPECTATION THAT THE LONGER RUN TREND OF MONETARY EXPANSION IN CANADA WILL MOVE AT A RATE COMPATIBLE WITH INFLATION-FREE GROWTH OF THE ECONOMY."

7. BOUEY ALSO MADE CLEAR THAT ANY WAGE/PRICE UPSURGE WHEN CONTROLS ARE LIFTED WILL NOT BE VALIDATED BY MONEY SUPPLY INCREASES. ACCORDING TO BOUEY, "NO GROUP IN THE COMMUNITY SHOULD COUNT ON THE BANK OF CANADA TO FLOAT OFF ITS INFLATIONARY ACTIVITIES WITH A WAVE OF MONETARY EXPANSION, AND IT IS PARTICULARLY IMPORTANT THAT THIS POINT SHOULD BE BORNE IN MIND WHEN CANADA ENTERS THE PERIOD OF DISMANTLING DIRECT CONTROLS."

8. COMMENT: BOUEY'S WARNING ON INFLATION AND ON EXCESSIVE STIMULATION OF ECONOMY TO CURE UNEMPLOYMENT

PROBLEM, COMING JUST BEFORE MARCH 31 BUDGET, GIVES  
ANOTHER CLUE TO TOP-LEVEL THINKING IN GOC REGARDING  
NEAR-FUTURE ECONOMIC POLICY. BOUEY'S REMARKS ON INFLATION  
CONCERNS AND WORRY OVER CANADIAN COST COMPETITIVENESS  
VIS-A-VIS U.S., CANADA'S BIGGEST TRADING PARTNER, LEAVE  
IMPRESSION THAT MACDONALD'S BUDGET WILL NOT CONTAIN MUCH  
FISCAL STIMULATION. ENDERS

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## Message Attributes

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